Microinsurance Innovation Facility

BRIEFING NOTE 9

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A BUSINESS CASE FOR MICROINSURANCE

An analysis of the profitability of microinsurance for five insurance companies

Janice Angove and Nashelo Tande

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Is there a business case for microinsurance? Under what circumstances can insurance companies generate profits from microinsurance? These are important questions as insurers are increasingly interested in expanding into the low-income market. To encourage this expansion, microinsurance initiatives need to demonstrate that they are commercially viable and sustainable over time.

This note[1] assesses the business case for microinsurance through case studies of five initiatives of insurance companies, outlined in Table 1:

Table 1 Overview of microinsurance initiatives

Insurer	Products	Target market	Distribution and administration
Co-operative Insurance Company (CIC) Kenya	Credit life (compulsory) Bima ya Jamii: voluntary bundled health and life insurance	Members of microfinance institutions (MFIs), savings and credit cooperatives (SACCOs) and other self-help groups	MFIs, SACCOs and other groups
Old Mutual South Africa	Burial Society Support Plan: group funeral cover	Members of burial societies, funeral parlours and savings clubs	Salaried agents who work with groups are responsible to sell and service policies
ICICI Lombard India	Manipal Arogya Suraksha: group health insurance Index weather insurance based on rainfall index	Community groups in coastal areas of western India Clients of MFIs, rural banks and other credit providers	Network of health care providers MFIs and other credit providers
Aseguradora Rural (ASR) Guatemala	Death and disability insurance Student life insurance (includes health care and hospitalisation cover)	Clients of BANRURAL (rural bank)	BANRURAL network of bank branches
Malayan Insurance Philippines	Life insurance with additional benefits (e.g. fire assistance)	Clients of pawn shops, rural banks and lending intuitions, co-operatives and NGOs	Pawn shops, rural banks and other credit providers

[1] This note is excerpted from the Microinsurance Paper no. 8, which includes the relevant citations and details on methodology and the cases reviewed. The paper is available at www.ilo.org/microinsurance. Janice Angove and Nashelo Tande are part of Quindiem Consulting.

FRAMEWORK TO ASSESS PROFITABILITY

The study uses a framework to identify the main drivers of profitability using key performance indicators and a qualitative assessment of the information gathered. The drivers are: 1) scale, 2) claims costs, and 3) acquisition and administration costs.

Continuous monitoring of product performance and the organisational structure of the insurer are additional factors that contribute to the viability of microinsurance initiatives.

How the insurers balance these often competing aspects of the business was analysed using case studies. Although the experiences are unique, investigating the challenges and successes of these microinsurance initiatives provides insights into approaches to improve viability for other players in the market.

Overall Profitability Assessment

To be viable business propositions, microinsurance initiatives must contribute to overall profitability of the business relative to their risk and the capital and other resources they require. Table 2 shows the gross insurance product excluding reinsurance costs for the products investigated in the case study.

CIC

Both of the CIC products studied are profitable. The credit life product, introduced in 2002, is more profitable than the bundled health insurance product and is the most profitable of all the products investigated in the case studies. CIC used its experiences in credit life to learn about the market. The profitability of credit life then supported the expansion into other microinsurance products like the bundled health product. This product was loss-making until it was re-launched as Bima ya Jamii and the health risk was assumed by the National Health Insurance Fund (NHIF).

ICICI Lombard

Both of the ICICI Lombard microinsurance products generated losses during the initial years. The weather insurance product, introduced in 2003, has been profitable since 2008, before reinsurance is taken into account. The MAS health insurance product has consistently generated negative returns, due to high claim ratios. To manage claims costs, ICICI Lombard negotiated lower treatment fees with the healthcare provider and increased premiums for groups with poor claims experience.

Old Mutual

Old Mutual was able to break even on its group funeral product after it controlled claims costs through measures to reduce the number of loss making groups. The salaried agent delivery model is expensive relative to premium volumes generated, an issue that is exacerbated by small group sizes.

ASR

The microinsurance products of ASR have shown significant profits since their inception in 2007. Both products achieved comparable level of profitability. The Life Cover product is a major contributor to the overall profitability of ASR due to its premium volume.

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Table 2 Gross profit

Insurer	Product	2007	2008	2009
CIC Kenya	Bima ya Jamii (Accidental death and disability bundled with National Health Insurance) Credit Life	60% 69%	51% 66%	27% 66%
ICICI Lombard India	Manipal Arogya Suraksha ("MAS") (Health insurance) Weather Insurance (Index-based weather insurance)	(30%) (35%)	(30%) 5%	(32%) 1%
Old Mutual South Africa	Burial Society Support Plan (BSSP) (Funeral insurance)	(20%) (25%)	(25%) (35%)	0% 5%
ASR Guatemala	Life Cover (Accidental death and disability) Student Cover (Accidental death and disability)	85%	46% 67%	67% 56%
Malayan Philippines	Microinsurance business (Mainly accidental death and disability)	47 %	35 %	47 %

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Malayan

The microinsurance products of Malayan Insurance have been profitable since inception. The provision of simple accidental death and disability products with additional cover (e.g. fire) and Malayan's partnership with the pawn shops, rural banks and credit providers with a vast footprint in the low-income market are identified as factors for its profitability.

DRIVERS OF PROFITABILITY

1- Scale

Low margins in microinsurance are often a function of insufficient premium volume to generate surpluses needed to cover product development costs. Scale is needed to achieve a stable pool of risks, and greater efficiency (economies of scale) in operations.

Covered Lives and premium volumes

The scale reached by a microinsurance product is often measured in terms of covered lives and premium. Table 3 shows the gross premium and covered lives for the products investigated in the case study.

Although most of the case studies show a substantial number of covered lives, microinsurance premiums (at 3 per cent or less for all the products except CIC's credit life and ASR's life cover) are relatively small compared to premium for traditional business. Microinsurance products will need to expand significantly to make a material impact on the insurer's total book of business.

Table 3 Premiums and covered lives

Insurer	Product	Gross Written Premiums			Covered lives		
		2007*	2008*	2009*	2007	2008	2009
CIC Kenya	Bima ya Jamii[2]	27	137	142	3 625	17 461	18 872
	Credit Life	2 196	2 356	3 919	159 047	170 725	256 762
ICICI Lombard India	MAS health insurance	539	1 008	1 323	318 334	511 456	550 194
	Weather Insurance	1 383	4 637	20 490	43 278	108 819	259 958
Old Mutual South Africa	Group funeral	N/A[3]			500 000 600 000	400 000 450 000	400 000 450 000
ASR Guatemala	Life Cover	2 143	2 603	4 789	42 184	75 004	123 429
	Student Cover		36	175		3 984	20 554
Malayan Philippines	Microinsurance business	815	1 246	1 913	4 113 975	4 334 887	5 009 089

*US$'000.

[2] The low policy volumes for the Student Cover and the Bima ya Jamii product is partly explained by the fact that these products are relatively new, having been launched in 2007 and 2008 respectively.
[3] For competitive reasons, Old Mutual chose not to disclose premium volumes.

The following factors were identified from the case studies as being important to achieve scale:

- **Working with existing groups and partners:** Leveraging existing relationships and building mutually beneficial relationships with the partner are important to access the market. Working with a partner with a wide footprint of branches or access points allows the insurer to develop a large, diversified customer base. ASR benefits from access to 4 million BANRURAL customers and Malayan's partnership with pawnshops provides access to a large segment of the low-income market.
- **Demand driven products:** Insurers in the case studies developed products to address existing demand with generic benefits that appeal to a broad customer base. For example, Old Mutual tapped into existing demand for funeral cover in South Africa with its group funeral product.
- **Compulsory enrolment:** Scale can be more easily achieved through compulsory products. CIC, ASR and Malayan's compulsory credit life products and basic accidental death and disability products have reached high volumes and are the most profitable. Compulsory enrolment needs to be balanced with client value considerations to make sure that the products are appropriate and that clients are well-informed.
- **Affordable and competitive premiums:** There is often tension between providing benefits demanded by the market and keeping premiums at an affordable level. Old Mutual and ASR introduced a range of benefit options to allow clients to select an affordable price point for benefits that they valued. For Old Mutual this was in response to a finding that a number of burial societies were lapsing as they were forced to select options where premiums were too expensive.
- **Incentives to sell and retain business:** Providing appropriate incentives to the agents or staff of the partner to sell and retain business is particularly important for voluntary products. ASR saw an increase in sales after implementing a sales incentives programme for sales staff at the individual as well as team level. Lack of incentives for the sales staff of partner MFIs and SACCOs resulted in low premium volumes for CIC's Bima ya Jamii product.
- **Client satisfaction** correlates with retaining business. Maintaining customer satisfaction through additional services is important in the competitive South African funeral insurance environment. Old Mutual makes a commitment to pay the claim within 48 hours of receipt of all documentation, and its agents assist the beneficiary in gathering and submitting the necessary documentation.

2- Claims costs

Claims costs are managed mainly through the product design, risk pricing, and risk management. Pricing the risks is a challenge because microinsurance involves new markets and products. Insurers often rely on existing experience when pricing microinsurance products, and make adjustments based on the experience of the product over time. Insurers need to implement and monitor processes to mitigate underwriting and claim risks (e.g. adverse selection and fraud). The following factors were identified to help manage claims costs in the case studies:

- **Pricing for the risk:** Credit life and basic accidental death and disability products are easier to price than health products or voluntary funeral insurance - this has been to the advantage of CIC, ASR and Malayan. Insurers generally used existing experience with similar products from the traditional insurance market and made adjustments for the low-income market. Old Mutual and ICICI Lombard experienced challenges with this approach. Claims experience with the group funeral insurance (see Box 1) and the MAS health insurance product respectively did not reflect initial estimates.

- **Claim controls:** Insurers need to balance between setting up sufficient controls to manage adverse selection and fraud risks, while maintaining efficiency and low costs. Old Mutual uses product features like a six-month waiting period and the compulsory nature of the product for all group members to manage anti-selection. ICICI Lombard works with a network of healthcare providers to provide treatment for health insurance clients. Treatment protocols are closely monitored by the claims team at ICICI Lombard to reduce unnecessary claims that might result due to fraudulent behaviour by providers.

- Monitoring experience and adjusting premiums over time: A number of insurers increased premiums or restricted benefits based on undesirable claims experience and set premiums based on the claims experience of specific groups, as opposed to a common rate for all clients. Varying claims experience from different groups reached through the pawnshop channel taught Malayan to price more accurately. Malayan adjusted the premium and removed covers like 'unprovoked murder assault' for individual groups.

Box 1 Re-pricing risk

Old Mutual's claims ratio has been close to or above 100 per cent in 2006 and 2007, higher than the target of 60 per cent. This is partly due to the higher claims experience of the target market compared with initial projections that were based on other market segments.

Old Mutual increased the composite premium and introduced differential pricing among groups. It actively monitored the claims and adjusted premiums on an ongoing basis, providing premium discounts for good claims experience and increasing premiums in the case of poor claims experience. These efforts resulted in the claims ratios declining to between 65 per cent and 75 per cent. Though these efforts resulted in a decline in sales, the smaller portfolio now is profitable.

3- Acquisition and administration costs

Many insurers work with partners to lower distribution and administration costs. The following factors are important to manage these costs:

- **Low acquisition costs:** working with partners with an existing client base and infrastructure to minimize costs. CIC and ASR work with partners that are the owners of the insurance company. They can access the infrastructure of the partners at no or below market cost, which represents a considerable advantage in keeping the acquisition costs low. Old Mutual is the only insurer that does not work with a partner to distribute and service its microinsurance business; not surprisingly, its salaried agent model showed the highest expense ratios for all insurers in the case study.

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- **Efficient administration procedures:** Simplicity of products, limited levels of ongoing policy administration, no or limited underwriting at the policy inception stage and efficient claim payment processes contribute to managing the costs of administering the microinsurance business. Insurers also leverage the infrastructure of the partner to collect premiums, pay claims, make policy amendments and communicate with individual policyholders. This has the advantage of reducing the cost of the initiative to the insurer, but relies on the partner to provide quality service and sell or renew polices.

CROSS-CUTTING FACTORS

The framework identifies two aspects of initiatives that cut across the drivers of profitability:

1- Organisational structure

The position of microinsurance within the insurer's organisation affects the costs of managing the business and the support for this business through cross-subsidies from traditional insurance products. At ICICI Lombard and ASR, microinsurance is managed in the same unit as related traditional insurance products. At ICICI Lombard units are structured along product lines (e.g. health). This allows access to skills and resources from the other business units and the expenses of the microinsurance initiative to be supported by other sources of company income. Old Mutual, on the other hand, set up a separate microinsurance business unit (the Foundation Market) to provide focus to the low income market as this business was being developed. Due to the high distribution costs, the Foundation Market still uses general infrastructure, resources and expertise from other business units. This illustrates the importance of having support from other business units during the early stages of a microinsurance initiative.

2- Monitoring experience

All the insurers studied devoted resources to engage in microinsurance, incurring marketing, development and training and information systems costs. However, for the most part the insurers did not formally monitor these costs. As a result it was difficult to assess the costs associated with each microinsurance product. Insurers need to monitor the specific costs related to the products in order to gain a fuller understanding of their financial performance and profitability.

CONCLUSIONS AND RECOMMENDATIONS

The analysis of the cases shows that insurance companies are able to provide microinsurance profitably. The experiences also show that achieving sustainable microinsurance operations is often an iterative process. This observation illustrates the importance of monitoring experience, continuously learning from the market, and making adjustments to the product and the pricing. Old Mutual and ICICI Lombard experienced challenges with the profitability of their respective group funeral and MAS health insurance products at the beginning. Both insurers were able to reduce losses by using remedial measures and are working on strategies to make the initiatives viable. Their persistence highlights the increased focus on microinsurance amongst the insurers reviewed.

While these five case studies provide valuable insights into the profitability of the microinsurance initiatives of the insurers, it would be premature to draw broad conclusions about the profitability of microinsurance. Further research into the performance of other microinsurance initiatives is needed. In addition, rather than investigating individual products, looking at the whole microinsurance initiative and investigating the cross-subsidies between different products would provide insights into the development of microinsurance.

The study considers mainly the viability of microinsurance, but a holistic review should evaluate whether products also provide value to clients. The question of viability needs to be balanced with the question of client value, because long-term sustainability depends on products meeting needs and providing value to clients.

Housed at the International Labour Organization's Social Finance Programme, the **Microinsurance Innovation Facility** seeks to increase the availability of quality insurance for the developing world's low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation.
See more at www.ilo.org/microinsurance

International Labour Office

microinsurance@ilo.org
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